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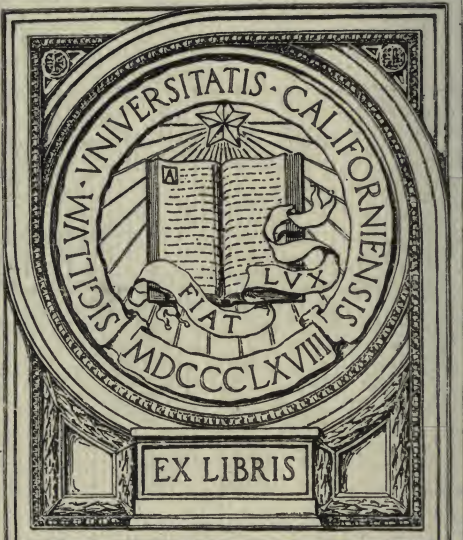

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WHAT CONSTITUTES THE COST OF DOING BUSINESS

THOS. A. FERNLEY

RELATING TO THE DISTRIBUTION
OF
MERCHANDISE AT WHOLESALE

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Philadelphia

What Constitutes the Cost of Doing Business

Relating to the distribution of Merchandise at Wholesale

THE ever-increasing fierceness of competition has demonstrated the necessity for the most careful management of business enterprises. Profits are too finely cut to permit a continuance of rule-of-thumb methods and greater concentration is necessary to obtain greater accuracy. Careful calculation plays a most important part in business to-day and success depends largely upon the inauguration of better methods all around, involving a means of securing clear, concise and accurate information relative to the condition of one's business.

This subject of the cost of doing business is of prime importance, and while there is nothing essentially new in the article herewith presented, perhaps it will serve to make business men think a little more deeply of the obligation due them by the business in which they are engaged.

The increasing cost of selling a given amount of goods has forced business men to look into the matter very thoroughly, and, if possible, find some remedy for the present conditions, although it is admitted that many do not understand the full significance of the question.

Lower Range of Prices

The increase seems to be partly explained by reason of the decrease in values during the past decades. It is now necessary to sell almost double the quantity of merchandise to equal the sales of twenty years ago.

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In speaking of this phase of the question, a jobber recently said:

"In April, 1884, we sold a bill of goods to a Wisconsin customer; the bill amounted to $546.01. In 1897, thirteen years after, we took the trouble to extend that same bill at prices then ruling, and found that at that time it would only amount to $359.17. In other words, the same goods were worth 30 per cent. less in 1897 than they were in 1884, and I venture to say they would net still less to-day. To carry this illustration further, we will say that in 1884 the profit on the goods was 10 per cent., which would be about $54.60. We will say that the entire expense of doing business, including travelers', store expense, etc., was 7½ per cent., or $40.95; this would leave a net profit of $13.65 on the bill. In 1897 the expense in dollars and cents would be precisely the same; and estimating the profit at the same percentage, we have a profit of $35.91, while the expense remains at $40.95. The same bill which in 1884 shows a profit of $13.65 would in 1897 therefore show a loss. Of course, we have taken the rate of profit at a nominal figure in both cases, so as to show the workings of the plan; but the situation is even worse than it appears, for to-day, owing to the increased traveling competition, this customer would not buy a bill of this size from one jobber, but would divide it among several, while this smaller quantity of goods would be sold on a closer percentage of profit."

Causes for Increased Expenses

Among other causes of increased expenses we find that with an increase in population, the number of distributors increases sometimes to a greater extent than seems necessary to supply the demands of the trade. As a result, the average value or amount of the individual order decreases, with a consequent increase in cost of handling, making necessary a more expensive organization to conduct the business.

The publication of expensive catalogues represents a development of recent years, which has added considerably to the expense account, as have also other modern advertising items which are generously provided for the benefit of the trade.

Again, the much talked-of higher cost of living through general advance of prices in foodstuffs and other commodities of life has resulted in a necessary advance in the scale of salaries and wages paid to all classes of help. It has also caused larger daily expense accounts of traveling salesmen through advanced hotel rates.

Senator Lodge, chairman of the committe appointed by Congress to investigate the causes of the higher cost of living, cited, among other causes, the following as the most marked:

"Increased cost of production of farm products, by reason of higher land values and higher wages.

Increased demand for farm products and food.

Shifting of population from food-producing to food-consuming occupations and localities.

Reduced fertility of land, resulting in lower average production or in increased expenditures for fertilization.

Increased banking facilities in agricultural localities, which enable farmers to hold their crops and market them to best advantage.

Reduced supply convenient to transportation facilities of such commodities as timber.

Cold storage plants, which result in preventing fluctuations of prices of certain commodities with the seasons, but, by enabling the wholesalers to buy and sell at the best possible advantage, tend to advance prices.

Increased cost of distribution.

Industrial combination.

Organizations of producers or of dealers.

Advertising.

Increased money supply.

Over-capitalization

Higher standard of living."

It is interesting to note that this congressional committee has recognized as an item of increased cost the increased cost of distribution.

The increased value of realty in the central and business districts of our large cities has forced wholesalers generally to pay rents far greater than in former years.

This, of course, means additional selling expense, hence the increased proportion of expense to gross sales.

Age Brings Increased Expense Account

When the house is young the expenses are at a minimum, partners probably doing a large portion of the work. As time goes on, the necessity for more help comes, and the old employes are constantly looking for and receiving increased salaries. Such a condition is apparent in many houses, and any attempt to "prune off dead wood" would be very difficult and would work an injustice to those who have given their best years of loyal service to the house.

Salesmens Salaries Higher

Efficient salesmen are demanding and receiving a larger remuneration. There is only so much business obtainable. It is hard to increase the volume, and if one merchant through aggressive measures does increase his volume, this will only be temporary, as others will adopt similar aggressive measures, which will result in an equalization of the volume of business.

Salaries of Principals

Some firms or corporations, where there are three or four principals only, have been in the habit of charging little or nothing to the expense account for the salaries of these principals.

Some cases have come to our notice where but $1200 or $1500 apiece has been charged off for those who would most assuredly not have accepted any such remuneration working for others, but who

saw fit to incorrectly minimize their expense account by charging off such inadequate amounts, relying upon the profits at the end of the year for their full remuneration.

In most cases such principals have been the most active men in the house; they have been Executive Heads, Buying and Sales Managers and General Managers.

Sometimes they have sold a large amount of goods in connection with their other duties. One particular case comes to mind where a member of the firm sold $60,000 worth of goods per annum, and in addition to that did all the buying for the house. No salary whatever was charged off either for work in the house or on the road.

Salaries for Principals Should be Charged

Surely for this work others would have been paid. Therefore, why not charge off some proper amount instead of having a member of the firm do this work and charge nothing for services rendered. How would such a partner fare if there were several inactive partners sharing equally in the profits?

Possibly a fair average estimate of what amount of salaries of active principals should be charged off would be double that of any other person in the employ of the house.

The principals not only furnish experience and expert guidance, but never-ending responsibilities and anxieties devolve upon them, and on their policies and actions depend the profit or loss shown by the business.

Where the principals do not actively participate in the conduct of the business others are well remunerated. Their salaries are, of course, charged off to the expense account.

Salesmen and Traveling Expenses

Every one should know in a general way what his salesmen cost to sell goods, what they cost in percentage and then compare his house costs.

Rent

It is rather startling that there is any diversity of opinion regarding such an important item as this.

Some firms have stated that they were under trifling expense, and when rent was mentioned have said, "What? Rent! Why, we pay no rent! We *own* the building. Of course, we charge off taxes and repairs to the expense account, but we have a great advantage over competitors in that respect, for they must pay rent."

Surely, if they would not have occupied the building it would have been rented at market prices, and in our opinion they should charge off every year the amount which they could secure for the property if it were rented to another party, probably 8 per cent. on the market value and repairs and taxes and water rent.

Interest on Capital

Charging interest on capital being a mooted question, it is probably well to present some of the various phases of the subject, as follows:

One may readily secure the current rate of interest on capital by investing in securities of such a character as to preclude any appreciable chance of losing the principal.

What a person expects to gain who embarks in business, superintending the employment of his own capital, is much more than the rate of interest.

The rate of profit should be far in excess of the rate of interest.

The first and prime duty of the business, therefore, is to earn the current rate of interest.

This should be without regard to dividends, for a sale is really made at less than cost, if not equal to or in excess of the invoice cost plus operating expenses, including interest on capital.

If interest on capital is included when making

up the cost, and the year is not a good one, the dividends will at least be guaranteed if sales have not been made at less than cost; and by cost is meant invoice cost plus operating expenses, including interest on capital.

Of course, losses must surely result in years of depression when sales are reduced to a minimum and the ratio of expenses to sales rises out of all normal proportion.

The surplus profit earned is partly in the nature of compensation for the risk involved. He who enters into business always exposes his capital to some, and in many cases to very great, danger of partial or total loss.

For this danger he must be compensated liberally; otherwise, of what use would it be to incur it?

Writing on the subject of "Profits," the eminent scholar, John Stuart Mill, said: "The gross profits from capital, the gains returned to those who supply the funds for production, must suffice for three purposes:

"First—They must afford a sufficient interest on capital.

"Second—They must afford a sufficient indemnity or surplus earning for the risks involved.

"Third—They must afford a proper and adequate remuneration for the labor and skill required on the part of the principals."

These different compensations may be paid to the same or different persons. It is thus clearly demonstrated that John Stuart Mill held the following opinions:

First—That it is essential to charge interest on capital to provide for him who furnishes it and who may not personally undertake the risks and trouble of the business.

Second—That the surplus earnings may readily be distributed to those entitled to them.

Third—That the salaries of principals should enter into the expense account in order to present a true statement of net earnings.

Necessity for Charging Interest on Capital

If a firm were to be started by men with a thorough knowledge of the business and but little capital they would be forced to borrow money and pay interest on it. To such a firm with inadequate capital, the charge of interest on capital is made through the necessary charge of the interest on the borrowed money, which constitutes their capital.

Suppose a case where two firms are doing an equal business, each using $100,000 capital—one has cash capital of the full amount, the other has but $40,000 cash—and borrows $60,000 charging interest on the borrowed money to the expense account.

Both concerns must earn a profit on the business done. If the concern with full-paid capital ignores the item of interest on capital, will they not fail to show as satisfactory a result at the end of the year as the other house?

In many cases where the owners of a business desire to retire and sell the business to old and trusted employees—a certain amount of capital may be allowed to remain in the business, the new purchasers paying the interest on the amount to the former owners.

In order to make any headway, and to ultimately make a success of the business and complete its purchase, it would be absolutely necessary to consider interest on capital as an expense and to include it when figuring overhead or fixed charges.

In this case the one who furnishes the capital is remunerated by the interest which must be paid

him, and this difference between the interest and gross profit may be laid aside as a surplus account for the purchase of the business.

Even if they had started with plenty of money they could have invested it instead of doing business, and secured interest.

In partnership, when the capital is not equally contributed, it is usual and customary to allow each partner interest on the amount of capital to his credit before any division of profits is made.

The most successful and conservative business men hold that interest should be charged upon capital, and that this should be charged to the expense account and not to the interest account.

A fair plan would be to charge at least 4 per cent. interest on capital to the expense account as a minimum amount for the capital to earn. This precaution will provide for at least this return, and the profit can readily be taken care of in annual dividends.

In arriving at the true cost of merchandise by the only proper method, viz., adding the overhead expense to the invoice cost, the cost will be too low and consequently incorrect if interest on capital is omitted. The expense account should be forced to bear the interest on all monies invested in every case.

This would include interest on capital, surplus and borrowed money.

Interest on Borrowed Money

It is also held that interest on borrowed money should be charged to the expense account, for in ninety cases out of a hundred it would not be necessary to borrow money were it not to accommodate some delinquent customers.

Bad Debts

A charge of the average percentage of losses should be made to the expense account to take care of bad debts, as it is necessary to include this in the cost to make the results satisfactory at the end of the year.

Recapitulation of Operating Expenses

The following summary shows the various items of expense to be considered:

Direct:

Salaries of salesmen.
Traveling expenses of salesmen.
Advertising, including catalogues.
Gifts to customers.
Salaries of buying department.
Expenses of buying department.
Labor and expenses of warehousing department.
Labor and expenses of shipping department, including all deliveries to transportation companies and to customers locally.

Indirect:

Salaries of principals.
Rent.
Interest on capital and surplus.
Interest on borrowed money.
Salaries and wages of house employes.
Dues to trade organizations.
Stationery.
Postage.
Telegraph.
Telephone.
Insurance: Fire, credit, casualty, partnership, bonds, liability, plate glass.
Depreciation on merchandise on hand.
Unjust claims by customers.
Charity.
Damage, breakage, loss, freight and express charges on returned goods.
Collections.
Miscellaneous expense.
Repairs.
Fuel.
Light.
Heat.
Power.
Freight.
Bad debts.
Store supplies.
Warehouse supplies.
Warehouse fixtures.
Store equipment.
Office equipment.
Taxes.
Legal expense.

It is far wiser when in doubt to charge an item to the expense account than to charge it to the merchandise or any other account.

Every expense which is shown on the ledger, every amount for which you have no positive credit return upon your ledger, is chargeable to the cost of doing business. In other words, practically every expenditure should be put in the expense account, except amounts paid for merchandise, and, in some cases, freight.

Exceptional or Special Business

Exceptional or special business should not be considered in ascertaining the average percentage of expense, for if included in the amount of gross sales, it will give an incorrect and misleading result and cause a loss on the regularly obtained business.

For example: A house enjoyed the patronage of a large public service corporation, and for a very small commission purchased their supplies.

They unwisely merged this special business into their regular sales to the trade and arrived at their percentage of expense accordingly.

Another concern through certain banking connections was in a position to finance companies which used material in which they dealt. In this manner a large volume of business was secured. Instead of treating it as special business when calculating the percentage of expense of conducting business, they merged it with their regular sales. The result was that while their regular business obtained through their salesmen cost them certainly 15 per cent. on the sales, they deceived themselves into believing that it cost them but 9 per cent.

This method of figuring may have led them to believe that they were unusually clever in handling their business, but their competitors who based their figures on regular business must have suffered as a result, and they themselves surely lost through their improper methods.

Sales of Staples

Attention should be given to the misleading effect of large sales of staples on the percentage of selling expense for the month or year.

It has been recommended by some that a separate record of large sales affording a profit of less than, say, 7½ per cent. be kept.

Such a record serves to keep clear the true percentage of expense, for certainly no sales of staples in bulk at a trifling advance over cost should be merged into the sales account of regular goods sold in small quantities at a greater expense.

No business man should allow himself to be deceived as to the cost of doing business by merging such sales into the regular sales account, yet not a few openly boast of their wonderful work in reducing their expense accounts by 2 or 3 per cent. when the truth is that the supposed reduction is caused by failure to segregate such large sales as are here referred to.

Cost of Selling Goods Shipped Direct from Factory

The question of the cost of selling goods which are shipped direct from the factory to the customer is one which is frequently brought up. The manufacturer urging this method, possibly with the hope of coming into greater direct contact with the small trade, claims that business handled by direct shipment costs nothing—that it is all "velvet"—clear net profit.

Is it not necessary to go to some expense to build up friendly relations with the customer?

Is it not necessary to pay the salesman's salary and expenses for securing this business?

Is it not necessary for well-paid buyers, sales managers and clerks to give their close attention to this business that it may be properly handled?

Is it not true that shipments from stock may be handled by a lower paid class of help, and that the business may be disposed of in a day or two instead of the two or three weeks necessary

to close a transaction when the goods are sent direct from the factory?

Is not the credit risk on direct shipments quite as great as on shipments made from stock, and is it not true that on direct shipments of heavy staples you are asked to incur a heavy credit risk for a transaction at no profit or a possible loss?

In fact, the only gain is a more prompt turnover of capital, a saving of warehouse handling and a saving of warehouse rent. It is still necessary to meet all the other items of expense as noted on page 10.

Do Expenses Decrease with Increased Sales?

Question: If it costs 18 per cent. to sell $100,000 worth of goods, the 18 per cent. taking care of the general expenses and all operating expenses, should it cost 18 per cent. or $18,000 to sell the next $100,000 worth of goods?

Answer: It should not, but it does.

Many have an idea that by increasing the volume of their business the percentage of expense can be materially reduced, but a reply to this by a large merchant is quoted as follows:

"We have an interesting illustration of the amount of expense in the years 1907-1908 and 1909. The year 1907 was a very good one. Our sales increased very largely as compared with 1906. Our percentage of expense decreased very materially. Then there was a pressure on the management to make improvements. We wanted more men in some departments. The sales department wanted more help. In 1908 we increased our expenses by adding more men to our office, stock and shipping force. So when the total of 1908 was compared with 1907 we found the increase in the expense account was very considerable. When you have a good year everybody will want something, and when there is a bad year you don't reduce that expense. There are good people you don't want to let go, and our expense account varies

from year to year. If we have a good year we catch up, but you have to increase help and expenses."

A Summary Illustrating the Conditions in Connection with the Distribution of Plumbing Supplies.

The following summary of a business of $500,000 per annum was given by Mr. Oscar J. Saxe, president and manager of the Dalton-Ingersoll Manufacturing Company, large wholesalers of plumbing goods in Boston, in a recent address before the New England Sanitary Club.

"Based on Gross Business of $500,000 *per year.*		
Capital of	75,000	
Borrowed Money	50,000	
		Percentage
Salaries and wages	$45,000	9
Rent	6,500	1.30
Heat, light and power	1,250	.25
Taxes	1,250	.25
Traveling expenses	7,000	1.40
Insurance	1,000	20
Interest, $50,000 borrowed at 4½ per cent	2,250	1.05
Capital at 4 per cent	3,000	
Cartage	6,000	1.20
Boxing	500	.10
Postage	1,250	.25
Stationery and printing	750	.15
Telephone	750	.15
Freight and express	500	.10
Catalogues, advertising, gifts to customers, charity and miscellaneous expenses	6,000	1.20
Bad debts	5,000	1.
Damage, breakage and transportation charges on returned goods	1,000	.20
Allowance and claims	1,000	.20
	$90,000	18.00

This 18 per cent. on the selling price is 22 per cent. on cost.

STATEMENT OF SELLING EXPENSES.

JOHN DOE & COMPANY,
Machine Tool Dealers.

Based on Gross Business of..$500,000 per year.
Capital of ..... 75,000 "
Borrowed Money ..... 50,000 "

	Amount in Dollars	Amount in Percentage
Salaries of principals.....	$9,000	1.80
Salaries of salesmen	10,000	2.00
All other salaries and wages..	6,000	1.20
Rent	6,000	1.20
Heat, light and power	1,100	.22
Taxes	600	.12
Traveling expenses	4,400	.88
Insurance	800	.16
Interest, $50,000 borrowed at 6 per cent.	3,000	1.50
Capital, at 6 per cent	4,500	
Cartage	300	.06
Boxing	1,200	.25
Postage	1,200	.25
Stationery and printing	1,000	.20
Telephone	600	.12
Freight and express	2,000	.40
Catalogues, advertising, gifts to customers, charity and miscellaneous expense	2,000	.40
Bad debts	2,200	.44
Damage, breakage and transportation charges on returned goods	500	.10
Allowance and claims	800	.16
	$60,000	12.02%

NOTE.—This 12.02 per cent. on the selling price is 13¾ per cent. on the cost.

STATEMENT OF SELLING EXPENSES.

DOE WHOLESALE HARDWARE COMPANY.

Based on Gross Business of ..$500,000 per year.
Capital of ..... 75,000 "
Borrowed Money ..... 50,000 "

	Amount in Dollars	Amount in Percentage
Salaries of principals.....	$9,000	1.80
Salaries of salesmen	18,000	3.60
All other salaries and wages..	10,500	2.10
Rent	6,000	1.20
Heat, light and power	1,500	.30
Taxes	950	.19
Traveling expenses	8,000	1.60
Insurance	800	.16
Interest, $50,000 borrowed at 4½ per cent.	2,250	.45
Capital, at 4 per cent.	3,000	.60
Cartage	5,000	1.00
Boxing	700	.14
Postage	1,000	.20
Stationery and printing	1,000	.20
Telephone	500	.10
Freight and express	1,800	.36
Catalogues, advertising, gifts to customers, charity and miscellaneous expenses	5,000	1.00
Bad debts	2,500	.50
Damage, breakage and transportation charges on returned goods	1,500	.30
Allowance and claims	1,000	.20
	$80,000	16.00

NOTE.—This 16 per cent. on the selling price is 19 per cent. on the cost.

Some Pertinent Questions to Consider

What is the percentage of cost of conducting your business? In figuring this, please take your total expense and total amount of business done, but do not include any special tonnage business, such as that which is referred to on pages 11 and 12.

What percentage does it cost you for the business taken by your salesmen? In answering this question you should not figure in the house expense.

What percentage does it cost for house expenses? In figuring this take total cost of running your business, less cost of traveling salesmen, and figure on the total amount of business done.

Do the officers of your company or the heads of your firm draw what you would call a reasonable salary? Would they accept a similar amount from others for services of a like nature and consider the compensation adequate?

Do you charge rent if you own your building?

Do you charge all possible moneys paid out to the expense account and consequently to the cost of doing business, so that your actual financial condition is revealed at the end of any stated period; or, are you careless and do you try to deceive yourself by making your showing better than it really is?

Do you keep a separate account of each department, so that you may know what percentage of profit each makes; what the gross profits are, and what the expense is, in order that you may have accurate knowledge of what every department is doing?

Do you figure the profit on all your sales, so that you keep yourself constantly informed of your condition, and take any steps necessary to bolster up profits, or do you wait until the end of the year to see what has happened?

Do you keep a record of each salesman's sales—

profits, salary and traveling expenses—and do you know what percentage of profit he has made after deducting his salary and expenses from the gross profits, not considering the house expense? If you do this, with the percentage of your house or inside expenses before you, you will know the actual value of each salesman. Some who are first in the sales column may be last in the profit column.

Do you charge interest on money used in the business as a factor in the cost of doing business, or do you look to your final results at the end of the year to take care of this, and run the risk of giving customers the use of your money for nothing?

Average Cost of Distributing Merchandise at Wholesale

The average percentage of expense of distributing merchandise at wholesale seems to vary but little in different businesses.

From authentic information and accurate data collected from a large number of wholesale houses the percentage of expense of distributing steam, gas and water supplies, plumbing material, mill supplies, electrical supplies, hardware and many other lines has been found to average between 15 and 16 per cent. on the sales.

Exact Figures Essential

Exact knowledge is exceptional in the world of commerce, but the fact remains that the prudent man who has an ideal record of costs and applies his knowledge practically is the one who out-distances all his competitors in the long run.

He is the one who adopts the methods calculated to attract the more profitable class of business; to handle the goods of quality in such a way as to more easily negotiate a profit; to avoid taking the unprofitable class of business generally fought for by those who do not count the cost. He who keeps the cost constantly in mind and directs his energies accordingly is the man whose business grows; whose new warehouses attract the favorable comment of the mercantile community; while his competitor who fails to chart his course with

such precision flounders about, making no progress, becoming more and more convinced that the fault is not his by any means, but that the business is hopelessly unprofitable.

In his recent article in *The World's Work*, Mr. John D. Rockefeller writes:

"Then, again, we had the type of man who really never knew all the facts about his own affairs. Many of the brightest kept their books in such a way that they did not actually know when they were making money on a certain operation and when they were losing. This *unintelligent competition* was a hard matter to contend with. Good old-fashioned common sense has always been a mighty rare commodity. When a man's affairs are not going well, he hates to study the books and face the truth. From the first the men who managed the Standard Oil Company kept their books intelligently as well as correctly. We knew how much we made and where we gained or lost. At least, we tried not to deceive ourselves.

"My ideas of business are, no doubt, old-fashioned, but the fundamental principles do not change from generation to generation, and sometimes I think that our quick-witted American business men, whose spirit and energy are so splendid, do not always sufficiently study the real underlying foundations of business management.

"I have spoken of the necessity of being frank and honest with one's self about one's own affairs; many people assume that they can get away from the truth by avoiding thinking about it, but the natural law is inevitable, and the sooner it is recognized the better."

Often in attempts to make a good showing, sales are forced blindly as far as a knowledge of net profit is concerned, when it would be far better if a careful investigation of the cost of handling business were made and practical common-sense and judgment employed in adjusting prices accordingly.

Manufacturers have always added their "overhead" and selling expenses to the other items entering into the cost before arriving at what they consider cost. Merchants, however, have not followed this custom, with the result that salesmen, and even principals have unconsciously felt that any amount secured above their invoice cost was profit. Following the manufacturers' method of using a true cost, sales could be made at cost without suffering any actual loss, as all operating expenses are taken care of in this cost. Were a merchant to sell goods at what he invariably calls his cost, however, he would suffer an actual loss equal to the amount of his operating expense.

Therefore, would it not be advisable to figure costs by adding the overhead expense and when discussing profits with manufacturers let it be understood that no profit is realized until the fixed charges are covered.

Speaking on this subject, a merchant said:

"Now, then, what is the proper cost of goods? Is it the price paid at the factory? Is that the cost? You add freight. Why? Now, are there no other expenses which are as much a part of the cost of those goods as the freight charges? Is not the expense of the man who buys those goods just as much a part of the cost? Is not the salesman's expense, or your order man putting them up, your bookkeeper, your bill clerk, your house managers, your postage, your rent, and every other individual item that is connected with the expense account part of the cost?

If these are a part of the cost, why not add them?"

Percentage of Expense Not the Same on all Goods

It should be borne in mind that the expense sustained by a business house during the year gives the average percentage of expense of selling all goods, but does not give the percentage of expense of selling any particular one of the many lines of goods handled.

It is well known that certain heavy staples in continual demand are less expensive to handle than are small goods on which the demand is lighter and the cost of handling greater. For instance, where the average cost of doing business is 15 per cent. it will probably cost in the neighborhood of 7½ to 10 per cent. to handle heavy staples. It will cost about 30 per cent. to handle high-grade small goods—bulky, fragile goods which are possibly of a seasonable character, and items where the unit of sale is small. Other goods which take up considerable space in warehouses probably cost about 18 per cent. to handle.

In arriving at the cost of handling the various lines or classes of goods, the proper proportion of the expense of doing business and the expense of each salesman in effecting sales should be segregated and charged against them.

A leading wholesale hardware house considers and charges specifically to each department or line of goods the following items of expense:

"1. Interest at . . per cent. on the amount invested in stock.

"2. Insurance and taxes on stock.

"3. A rental charge for the floor space occupied in store and warehouses, together with repairs and alterations, and insurance and taxes on buildings.

"4. . . per cent upon the amount of sales for a provision against bad debts.

"5. The salaries and other expenses incurred exclusively (including any travelers engaged specially) for the department.

"6. Departmental advertising and expense of catalogues in proportion to the amount of space occupied.

"7. A proportion of all general traveling expenses calculated on the basis of the cost of sales made.

"8. A proportion of all other general salaries

and expenses of the house, based on the cost of the total sales of the house and calculated on the cost of sales in each department.

"(NOTE.—General expenses comprise salaries of officers, cashiers, bookkeepers, entry clerks, etc., whose services are of a general character and cannot be segregated into one or more departments; the proportion of rent for offices, aisles, etc., also postage, light, heat, cleaning, stationery, advertising of a general character, telephones and telegraph, donations, and the other sundry expenses which are necessary in conducting business.)

"The sum total of these general expenses is divided among the various departments in proportion to the cost of the goods sold, for the reason that it is considered a more equitable basis than the amount of sales, because it would be unfair toward a department manager who obtains a good rate of profit on his goods to be charged a heavier rate of expense in consequence, as compared with a department showing a lower rate of profit.

"Consideration should also be given to the number of times a year that the goods can be turned; the proportion which the item bears to the whole amount of goods sold; the portion of the hauling and packing account which the item should assume.

"In dividing traveling salesmen's salaries and expenses, a less proportion is segregated against the departments comprising heavy staples, for the reason that less time is necessary for selling these articles than the general line of goods.

"By means of this close calculation of the various expenses the actual cost or business expense of each department is arrived at, and a percentage representing the total of such expense is added to the flat cost of the goods in each department, in order to obtain the catalogue or store cost prior to the addition of the proper percentage of profit."

The percentage of expense of handling any

given line of goods or a class of goods in which a particular line would naturally fall, can be ascertained by following the rules above. This plan may appear to be somewhat radical at first glance, but it is not so much so as one would think.

It is not necessary to employ a high-priced statistician to figure the cost down to the hundredth part of 1 per cent., but the cost of handling different classes of goods may readily be ascertained by a careful calculation and consideration of the conditions under which they are handled and sold.

In every business there are staples which are sold at a trifling advance over the invoice cost.

Cost of Selling Staples

Now, if it is ascertained that it costs 7½ per cent. to distribute these staples and they are sold on a margin of but 2½ per cent. profit, the fact that you know that it costs 7½ per cent. to handle them may not immediately result in a higher price being secured, but certainly when you keep before you the fact that you are sustaining a loss of 5 per cent. on their sale something will be done to at least cover the expense of selling.

It has been remarked that merchants will sell goods down to a basis of 2½ per cent. profit, but that one rarely hears of a merchant selling goods right down to invoice cost. If staples cost $1 and the expense of distribution is 7½ per cent., why could not the selling price at least be made equal to the true cost which would be in the neighborhood of $1.08½ (considering that the cost of doing business is always figured on the selling price, which would make it about 8½ per cent. added to cost) so as to avoid a loss on the transaction.

Again, with the present method of selling staples at an advance of but a trifle over net cost, it is necessary to secure an extortionate profit on other goods to make up the deficiency. Such a practice

is bad in its effect on the business, and forces business men to do some things which are harmful and inequitable in the extreme.

A prominent merchant said some time since in addressing a body of business men:

"Now there is another question that I would like to put to you in this line: Did you ever stop to think where demoralization of prices stopped? Now, gentlemen, you all say that you cannot get this price and cannot get that price. Have you ever had a salesman that sends in an order that he don't get a little more than factory price or cost of goods? Is not that true? Just consider and see if it is not a fact that in all the great demoralizations of prices that we have been compelled to go through, and I speak of not only the present condition, but of four years previous to last year, if the bottom that was reached on goods was not within 5 per cent. of the factory cost. Why was it gentlemen? Why did it stop there? If demoralization takes place and there is no control of the prices, why do you stop at any particular point? Did you ever stop to think of it? Instead of selling those goods at $1.05, why did he not sell at 90 cents? I tell you, gentlemen, because that salesman came home and looked you in the face and said, 'I could not get any more money on this, but I got $5 on this sale and that produces that much toward the expense account.'

"Gentlemen, you will not stop demoralization, it is my belief, until you fix the cost and your salesman will not go very far below that cost. That is the first great strong powerful step for us to take. Put on a cost that includes all fixed charges of doing business."

It may be said "The plan sounds all right, but is it practical—will it work out?" In answer to this possibly the best reply is that it is and has been found entirely feasible and quite satisfactory by those houses who have adopted it.

By following this plan selling prices may be equitably based on the true cost of handling each line or class of goods.

If under a haphazard plan of pricing—some goods costly to handle have been priced too low—a readjustment can probably be made readily. In fact, you will have selling prices based on precise knowledge of costs, and no sales can be made at less than your true cost without an instant realization of the fact.

The general impression among manufacturers seems to be that goods should be distributed on 10 per cent., and that 15 per cent. is a fabulous profit. It is patent to the jobbers, however, that such differentials are not remunerative and scarcely cover operating expenses.

A Small Profit But It Must Be Net

A profit of 5 per cent. would undoubtedly be satisfactory to the jobber, but this 5 per cent. must be "in the clear," after the expense of distribution has been defrayed.

Again, figure true costs, and do not deceive yourself. If goods are billed at $1 each and it costs you 15 per cent. on the sale to sell them, speak of your cost as $1.18, and let it be known that no profit is made unless the sale is made in excess of that figure.

Public opinion generally seems to be opposed to combinations to uphold prices. The time has come, however, for business men to bolster up a declining range of prices by protecting themselves and the investors whom they represent.

Mercantile pursuits must do more than return a meagre 5 or 6 per cent. dividend for the lifeblood which is poured into them. Such a return could easily be swept away by some unfavorable turn of the market.

A Poor Return

It has been the experience of some merchants to conduct a business of $500,000, $1,000,000 or $2,000,000 per annum at an average percentage of expense of 15 per cent. over a period of years. The dividends declared have amounted to but 7 per cent., or a net profit on the turn over of but 1½ per cent. Would not a slight turn for the worse in the market, a few heavy loses or a run of unjust claims wipe out such a narrow margin?

A Profit Must Be Negotiated

Years of intelligently directed labor and ownership and skillful management of a large business enterprise should bring a proper reward.

These years should witness the accumulation of a snug fortune as a provision for later years and posterity. How such a proper ambition could be achieved from a business offering such small returns is not evident, and will probably continue to be impossible unless a changed policy is adopted by business men generally.

Every man starts out in business to make a profit; but nine out of ten men forget to see whether their business is profitable as it progresses. They imagine that orders mean business; and that business means profit; the more business the more profit. This is a fallacy that has often been proved in that severe school of commercial education, the bankruptcy court.

Why will men do business without a profit? Do they desire to become public benefactors, paying help and working to distribute the wares of various manufacturers without recompense? Will any one thank them for it?

Will the customers who have benefited put forth a hand to save a bankrupt from the workhouse, when ruined in business and broken in health? No! not a bit of it. The world will move on, shrug its shoulders, and say, "Why was he fool enough to work at no profit?"

All reason and common sense should tell a man that he must work to make a profit, and no profit can be made until after the operating expenses are defrayed. Every man in business ought to have constantly staring him in the face the words, *Make a profit!* Write it large, have it prominently before you every minute, impress its importance on every employe who has to do with sales. Rub it in thickly for it breeds success—"*Make a Profit!*" "Make a Profit!" "MAKE A PROFIT!"

Hard Work for a Small Return

The demand for a better and more equitable return is fully justified and must be pressed. We give to our business all we have of time, of labor, and devotion, and if we are its servants, at least it should pay us well, for our service is with more than the laborers' wage.

How many hours have you worked, how many days a year, to make a beggarly 6 per cent. clear on your investment? How many times have you gone home sick with the worries of a business whose expenses were *howling like wolves at the heels of its profits?*

And what for? Partly for the same reason that prompts every man—that dogged spirit that is in all of us, the grim determination to make a success of a hard game. Partly that and partly because the profit must be wrung from the business if we are to live. Most of us are willing to pay the price and succeed, but at what a terrible cost.

The opportunity has now come for men of commerce to develop their business to a more profitable degree by discontinuing the old false cost system and making every day grow bigger in its dividend-earning power by selling goods at a price based on the true cost, viz., the invoice price plus the operating expenses, paying proper attention to the varying cost of handling different lines of goods.

In this way, and in this way only, will the profit possibilities of the business of distributing merchandise be realized.

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